1 February 1982

MEMORANDUM FOR THE RECORD

SUBJECT: Meeting of Cabinet Council on Economic Affairs, 29 January 1982

1. A meeting of the Cabinet Council on Economic Affairs on 29 January 1982 discussed papers prepared by Treasury and State on Polish debt, Polish and Hungarian membership in the International Monetary Fund (IMF), and multilateral development banks.

2. Polish debt: Assistant Secretary Leland (Treasury) emphasized that USG policy objectives with regard to the Polish debt are to try to obtain maximum leverage over Warsaw by using the threat of default and by continuing to maintain an atmosphere of uncertainty. This will keep the Poles scrambling for funds to cover their debt service obligations and will help to keep bankers bearish about lending to all of Eastern Europe. He stressed that this was a "tougher" position than declaring Poland in default and thereby relieving them from their debt service obligations. The USG will treat the Polish debt normally and will keep the pressure on by continuing to urge the Poles to repay debt service owed to their government creditors and to complete the 1981 bank rescheduling. There is unanimity among the Allies that 1982 rescheduling negotiations cannot begin unless these conditions are met and without some improvement in the domestic political situation.

3. Vice President Bush emphasized the need to provide a study very soon of the impact of invoking the tank clause and how it would influence the international capital markets and West European banks. He stressed that the President is definitely going to do something more in the way of sanctions and probably

soon. He suggested that a policy options paper be prepared, explaining how additional USG measures could put pressure on the USSR and the rest of CEMA.

4. In reporting on recent talks with the Allies, Assistant Secretary Hormat (State) was encouraged that progress was being made in bringing them closer to our views. The Allies have agreed to provide only food credits for humanitarian needs, to cut off credits on exports of manufactured goods to Poland, and to insist that the 1981 bank rescheduling be completed before any thought is given to discussions of rescheduling 1982 official debt. There was some discussion of ways to make it harder and more expensive for the Soviets to borrow. Some countries are also thinking of ways to restrict the entry of Soviet exports into European markets.

5. Undersecretary Ikle (DOD) suggested that a top priority objective should be to reduce CEMA access to credit not just this year but over the longer run in order to impair Soviet economic capability. He said that the USG needs to focus on devising a longer term strategy in order to undermine the Soviet economy. Assistant Secretary Leland pointed out that the USG is not one of the big players in the area of trade and financial relations with Eastern Europe but, in any case, we can try to be spoilers. He stressed that the real issue is what Western governments will do since--according to his information--private banks are not lending to Eastern Europe.

6. <u>IMF Applications by Hungary and Poland</u>: The Council decided to try to pressure IMF management to delay the mission planning to go to Warsaw in March to discuss membership negotiations, and to delay a decision on whether USG pressure should be brought to bear to try to keep Hungary out of the IMF. On the present schedule, Hungary could join in three or four months.

7. <u>Multilateral Development Banks</u>: Undersecretary Sprinkel (Treasury) presented the main conclusions of the Treasury paper and the Council endorsed Treasury's policy recommendations. Budget appropriations for these institutions (the World Bank Group, the InterAmerican Development Bank, the Asian Development Bank, and the African Development Bank) will be lowered and the USG will encourage these banks 1) to foster the development of free, open markets and reliance on the private sector; 2) to emphasize countries who are helping themselves; 3) to rely more on co-financing and participation by the private sector; 4) to

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insist on policy conditionality and closer cooperation with the IMF; and 5) to pursue graduation policies in order to encourage these countries to approach the private capital markets.

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